DEPARTMENT OF STATE

AIRGRAM

Set 2 Libya

FOR DM USE ONLY

148

A-129 NO.

CONFIDENTIAL

HANDLING INDICATOR

RS/R-File

TO : DEPARTMENT OF STATE

INFO: LONDON, PARIS, OECD/PARIS, USCINCEUR

DEPT PLEASE PASS: ALGIERS, CARACAS, BEIRUT, CAIRO, DHAHRAN, JIDDA, KUWAIT

FROM : Amembassy TRIPOLI

DATE: August 12, 1971

SUBJECT: LIBYAN OIL: The Current Scene and Outlook

REF :

EXCISE

TABLE OF CONTENTS

	Page
SUMMARY	2
RESULTS OF THE 1971 AGREEMENT	
- LARG-Company Relations	2
- Production Decline	3
- New Investment Lacking	4
ATMOSPHERE AND ISSUES	
- Nationalization	5
- Employment and Production	6
- Other Issues	7
- Effects	7
OUTLOOK	
- Government-Company Relations	8
- The National Oil Company	8

DEPARTMENT OF STATE A/CDC/MR

REVIEWED BY CJ DATE 6/22/81

PORTIONS DENIED AS INDICATED

GROUP 4
Down-graded at 3-year intervals; declassified 12 years after date of origin.

CONFIDENTIAL

FORM 4-62 DS-323

FOR DEPT. USE ONLY ☐ In ☐ Out

Drafted by: ECON:JPlacke

Contents and Classification Approved by: AMB: Joseph Palmer 2nd

Clearances: DCM: HGJesif

A	REP 1	AF
A	EUR	FE
A 1	CU	INR 6
2	P	IO
	FBO	AID 20
R	COM 12	FRB 3
T 1	LAB 6	TAR 2
4	XMB 4	AIR 5
MY 3	CIA 16	NAVY 5
D 4	USIA 10	NSA 3
	opic 12	dep 1

Pass 11

COPYFLO-PBR

RELEASED IN PART

DECLASSIFIED

SUMMARY

The tension which has surrounded the Libyan oil industry for most of the past two years has diminished in intensity, [redacted] B1 Struggles over operational matters have not been resolved, even by the 1971 agreement on financial terms, nor are they likely to be -- [redacted] B1 The companies' reaction to this circumstance has been to avoid new risks and to shrink their operations in an effort to increase profitability [redacted] B1 The coming round of negotiations over the issue of direct government participation in established operations may, at last, address basic issues. The LARG aspires to maintaining a position of policy leadership among the major oil exporting countries and is laying the groundwork for the next round [redacted] B1 by moving to develop its National Oil Corporation as rapidly as possible.

RESULTS OF THE 1971 AGREEMENT

LARG-Company Relations

The April 1971 agreement on new financial arrangements between the LARG and the companies was a relief to both sides because of the intense struggle which preceeded it. For its part, the LARG, through its chief negotiator, Deputy Prime Minister Jallud, hailed the agreement as a basis for new cooperation. To underscore his point, Jallud told the company managers assembled to sign the agreement that he would be available to assist them in resolving operational problems to their mutual benefit.

Not surprisingly, the agreement has not lived up to such bright promise. [redacted] B1 the companies' operational problems have multiplied. Yet, they have not yet taken up Jallud's apparently sincere offer.

DECLASSIFIED

DECLASSIFIED

There are at least two reasons for this. While some problems are common to virtually all of the oil operators, e.g., production and development drilling controls, there are more problems which affect each company differently. The competitive instinct survives in the private oil industry, [redacted] B1 More importantly, the industry as a whole is reluctant to commit new investment to Libya, even if the LARG were to relax some of its restrictions. Hence, the companies have fought their daily battles individually and retreated slowly in a broken formation.

Production Decline

The 1971 agreement has had an important impact on Libya's standing as a major oil producer. The petroleum press has documented the decline of Libya to the status of a static, although still important, supplier of oil to Western Europe, which purchases the bulk of Libyan production. As tanker rates have dropped in recent months, Libya's oil has become expensive relative to Persian Gulf supplies hauled around Africa. Oil production normally stabilizes or declines slightly during the spring and early summer months, but the decline for Libya this year has been extraordinary. The rate of oil production has dropped from 3.0 million barrels per day (b/d) in March to 2.7 million b/d for June 1971. Publicly, the companies have explained that technical factors were partially responsible. [redacted] B1 Those independent companies which rely heavily upon Libya as a source of oil have been hit hardest, [redacted] B1

So far, the LARG has not reacted to this reversal of Libya's historic role as a supplier of low-cost oil. When or whether it will do so is uncertain because one of its interim objectives has been to limit production to conserve a dwindling asset from which even the present level of income exceeds Libya's absorptive capacity.

DECLASSIFIED

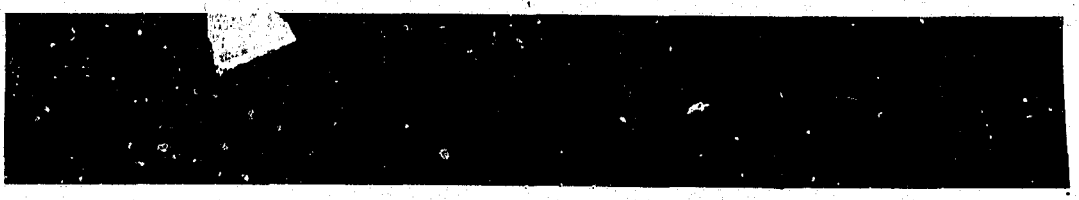
DECLASSIFIED

New Investment Lacking

One of the benefits sought by Libya in the 1971 negotiations was a renewal of investment in exploration for new oil reserves. "A barrel of new oil for every barrel exported," was the LARG's motto. In the end, a compromise was reached which obligated each operating company to 12 rig-months per year of oil exploration activity. Yet, four months after signature of the agreement, exploration drilling has hit a new low.

At the time of the revolution in September 1969, there were 52 drilling rigs operating in Libya. In March 1971, there were about 14. Currently 10 rigs are operating, with the immediate prospect of a decline to 8.

The cause does not lie entirely with company assessments of Libya. The LARG has consistently refused to permit development wells drilled in existing fields to be produced, even when there is a risk that reserves may be permanently lost (at least under conventional economic assumptions). Development drilling, therefore, has stopped, except for AGIP's new field. In supervising exploration drilling under the 1971 agreement, the LARG has refused to classify any well drilled within 10 kilometers of a proven field as an exploration well. In effect, the LARG is attempting to force the companies to by-pass prospects near their present pipeline facilities to search for oil in unexplored areas -- but in a climate which discourages long-term investment. The companies have refused.



B1

The most precise test of the 1971 agreement developed within the last month, when Mobil brought in a 6,000 b/d discovery well for which it had obtained an exploration classification from the Ministry of Petroleum. The well is located in concession 11, near an existing Mobil pipeline. [redacted]

B4

B1

ATMOSPHERE AND ISSUES

Nationalization

The abrupt elimination of the monarchy radically changed the atmosphere surrounding the oil industry in Libya. The period from the revolution of September 1, 1969 through the price negotiations which ended in April of this year was marked by uncertainty and an impression of high risk. Although a basic uneasiness remains, the level of tension has dropped noticeably since the 1971 negotiations. In some respects the atmosphere has improved.

The prospect of nationalization is now seen for what it is

B1

B1

Before leaving this murky area of prediction, however, two contrary influences should be noted. One, of long standing, is the instability injected by Libyan sentiment over the Palestine issue. Were hostilities between the Arabs and Israel to resume -- regardless of how they started -- [redacted] B1 The other influence is the desire being articulated within OPEC for "participation" in foreign-controlled oil operations.

Employment and Production

Other changes in the atmosphere have taken place. The LARG has learned a great deal about the mechanics of the oil industry. As a result of this knowledge and added self-confidence, [redacted] B1

A year ago, in the context of Libyanization and the first round of posted price negotiations, the LARG engaged in widespread deportations of company personnel and in arbitrary production cuts, which at one point halved Occidental's production to 400,000 b/d. Deportation [redacted] B1 seems to have been dropped, partially because there are fewer targets and partially because the LARG's increasingly discriminating control over visas and work permits has been found to be equally effective and less disruptive. The number of foreigners employed in the oil industry has dropped by 500-600 over the past two years, while Libyan employment has boomed.

Threats of production cuts are still employed, but on a more restricted scale and with greater selectivity than before. For example, Oasis Oil Company was encouraged to commit itself to a gas reinjection scheme several months ago by an order to shut-in a small, high gas/oil ratio field, accompanied by an implied threat that more drastic action would follow if the company did not comply, as it soon did.

Production controls need to be differentiated, however, between those imposed to exert pressure and those enforced for economic reasons. The restrictions, totaling about 500,000 b/d, which have remained in effect for the past year are in the latter category. These were imposed as a means of economic conservation -- to gear production more closely to the LARG's revenue requirements and to stretch out Libya's potential for high-volume oil production. Secondarily, they served to raise crude oil prices by reducing the total supply of short-haul, low-sulfur oil.

Other Issues

In areas less dramatic than employment and production, the LARG has steadily enlarged its sphere of influence and is expected to continue to do so. Company accounts are under close and continuing inspection, new wells are drilled only with government approval and, more recently, it has become virtually impossible to perform any well servicing or drilling operation without advance government approval.

Many, if not most, of these controls have long been practiced in the United States and some other major oil producing countries. [redacted] B1 The expanding load of technical requirements imposed on the companies must also be viewed against the background of the companies' diminishing pool of experienced employees. It is little wonder then that frustration dominates attitudes at the working level in the foreign oil companies.

[redacted] LARG continues to B1 tighten its grip on the oil companies' operations. Oil issues, [redacted] are: regulation 9 (institutionalizing government financial and accounting controls), and moves to restrict or eliminate the companies' present right to international arbitration and the requirement (already unobserved) for the companies' consent to changes affecting the terms of their concessions.

Effects

[redacted] B1 It has been replaced by withdrawal from high risk ventures, relinquishment of about 45 million acres of concession territory, movement of administrative functions out of Libya, and reduction of current, and especially, investment expenditure.

[redacted] What is

left of the once-burgeoning Libyan oil industry is a leaner structure designed [redacted] to hold on to existing productive investment as long as possible -- [redacted] B1

OUTLOOK

Government-Company Relations

The outlook in this area is for more of the same. The chances are good that there will be a new round of negotiations within less than a year. [redacted] of the companies to live up to [redacted] B1

How serious the participation issue becomes will depend upon the willingness of other OPEC members to join a new round of negotiations. [redacted] B1

[redacted] B4 B1

The National Oil Company

The National Oil Corporation (NOC) is the LARG's instrument for petroleum development for the future. The company has been allocated $60 million for capital investment in this year's development budget. With these funds NOC is:

a. reorganizing and modernizing the three privately operated oil products distribution companies nationalized in 1970,

DECLASSIFIED

b. contracting with Italy's SNAM for construction of a 60,000 b/d refinery near Tripoli,

c. designing the support facilities for a petrochemical park,

d. preparing to conclude a $16 million 50-50 joint venture with Occidental for a 1,000 ton per day methanol plant,

e. tendering its first geophysical exploration contract,

f. continuing to produce (at around 5,000 b/d) the Umm Farud field relinquished by Phillips in January,

g. recruiting foreign technical and managerial personnel and training about 150 Libyan technicians and process operators abroad.

There is no doubt that the NOC's operations will continue to expand. Libya is determined to have a "petrochemical" industry -- [redacted] (B1) A large amount of acreage relinquished within the past year has been assigned to the NOC. More is likely to follow. There are indications that the LARG not only is tolerating massive relinquishments but is pleased with them on the basis that it can relet the acreage under more attractive service contract or joint venture terms. There are further indications that contract and joint venture proposals for exploration of relinquished acreage will be invited through the NOC in the fairly near future, and recently Shell agreed to a joint exploration contract.

To develop its own potential, the NOC hopes to follow the path of Algeria's Sonatrach in forming joint ventures with foreign oil service companies. Nearly one year ago, the NOC began to pressure selected service companies for formation of joint ventures which would eventually have a monopoly in Libya. Later the pressure was withdrawn, but desultory negotiations have continued with Ray Geophysical Company, for exploration, and with Santa Fe and International Drilling Company for drilling -- all of them American firms.

Given the LARG's drive for national control, it seems likely that the NOC will continue to seek to become a fully integrated oil company including foreign processing

DECLASSIFIED

and marketing operations.

[redacted]

87

PALMER

CONFIDENTIAL

DECLASSIFIED